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PP RUEHCHI RUEHDT RUEHHM RUEHNH
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ZNR UUUUU ZZH
P 081030Z JAN 09
FM AMEMBASSY JAKARTA
TO RUEHC/SECSTATE WASHDC PRIORITY 1175
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
INFO RUCPDOC/USDOC WASHDC 1549
RHMFISS/DEPT OF ENERGY WASHINGTON DC
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UNCLAS SECTION 01 OF 03 JAKARTA 000031

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E.O. 12958: N/A
TAGS: EFIN ECON ETRD EINV EAGR ID

SUBJECT: BANK INDONESIA CUTS RATES 50 BASIS POINTS TO BOLSTER GROWTH, AS INFLATION EASES AND EXPORTS (AND IMPORTS) CONTINUE TO SLIDE

Ref: 08 Jakarta 2206

¶1. (SBU) Summary: Bank Indonesia (BI) reduced the overnight policy interest rate by 50 basis points, to 8.75%, on January 7, surprising markets which had expected a quarter-point cut. The move is aimed at supporting economic growth, which BI forecasts will slow to 4-5% in 2009. The rate cut followed the easing of consumer price inflation in December to 11.06% y-o-y (and deflation of 0.04% m-o-m), lower inflation expectations and recent firming of the rupiah, which had strengthened by over 10% against the USD since BI's December 4 rate cut. Indonesian exports continued to slide on weak demand for commodities, falling 11.09% m-o-m in November. Imports fell by 17.87% m-o-m for the same period, resulting in an improved trade balance of USD 890 million for the month. The rupiah, which had firmed on January 7 in advance of the rate cut, strengthened further after the cut, though pulled back slightly in mid-day trading on January 8. End summary.

Lower Inflation Eases Way for More Aggressive Rate Cut

¶2. (U) BI's more aggressive 50 basis point cut extended monetary easing begun in December, when BI lowered rates by an initial 25 basis points. BI's monetary policy statement advised that to counterbalance risks in 2009, monetary policy should focus on promoting economic growth, while continuing to safeguard medium-term inflation and financial sector stability. It noted domestic inflationary pressure had steadily eased in recent months in response to falling world commodity, food and energy prices, high levels of domestic food production in 2008 and a slowing of aggregate demand, giving BI added room to reduce rates. The rupiah, which had rallied by more than 10% since BI's December 4 rate cut, had strengthened on January 7 in advance of the latest cut, and

firmed further following it. The rupiah closed at IDR 10,863/USD (BI average rate) on January 7 and strengthened to IDR 10,805/USD in late trading. On January 8, the rupiah pulled back slightly, trading at IDR 10,940/USD mid-day.

¶3. (U) Consumer price inflation (CPI) slowed to 11.06% y-o-y in December, registering a 0.04% drop m-o-m. This was an improvement over November CPI rates of 11.68% y-o-y and 0.12% m-o-m. BI lowered its forecast for 2009 CPI to 5%-7%, down from 6.5-7.5%. While Indonesia's inflation rate is falling more slowly relative to most other countries in the region, December CPI came in lower than analyst expectations of 11.38% y-o-y. December consumer price deflation stemmed from two government decreases of subsidized fuel prices (by 8.3% on December 1 and 9.1% on December 15), which drove down prices in the transportation, communications and financial services category by 2.74%. Inflation expectations had also moderated in recent weeks. BI's monetary easing came on the heels of marked improvement in Indonesia's bond market, where yields have fallen by 500 to 650 basis points across the yield curve since early November. On January 7, yields on the 10-year benchmark domestic bond closed at 11.11%.

International Reserves Up, Bank Credit Growth Down
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¶4. (U) BI reported reserve assets increased to USD 51.639 billion at the end of December (up from USD 50.18 billion at end-November), equivalent to 4 months' of imports and government foreign debt payments. BI expects reserve assets will total USD 51 billion at year-end 2009, equivalent to 4.7 months' of imports and government foreign debt payments. Growth in bank credit eased from 37.1% in

October to 30.2% y-o-y in December (based on preliminary data). BI expects bank credit growth to moderate in 2009 to between 18-20%. BI cautioned that the global financial crisis and the world economic slowdown would weigh on Indonesia's banking sector in 2009, but reported that key capital adequacy (CAR) and non-performing loan (NPL) ratios remain satisfactory. CAR has dropped to 14.3% (down from 16% in October) and NPLs are forecast to trend higher in 2009, with the expected level to reach about 5% (which would be a significant increase over the most recent NPL levels of 3.9%).

Monetary Policy Easing Welcomed As Needed Complement
To Government's Fiscal Stimulus Package
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¶5. (U) The business community welcomed BI's more aggressive monetary easing. The business community had been clamoring for significant rate cuts to spur domestic demand and to complement government action to stimulate the economy, including an expanded fiscal stimulus package of IDR 50.5 trillion (USD 4.6 billion) announced by President Yudhoyono on January 4. Some local market analysts and bankers have questioned whether the BI rate cut will lead to a quick, corresponding decline in deposit and lending rates, as the interbank market continues to face liquidity imbalances and lack confidence.

Exports and Imports Continue To Slide in November
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¶6. (U) The growing global economic slowdown continues to weigh on Indonesian exports and imports. Statistics Indonesia reported total exports were down 11.09%
m-o-m in November (and down 2.3% y-o-y), to USD 9.61 billion, following a decline of 11.61% m-o-m in October.
Key export results (on m-o-m basis) included:

Rubber	-27%
Mineral fuels/oil products	-19.5%
Electrical machinery	-13.4%
Mechanical appliances	-11%
Fats/vegetable oils	-3.7%
Apparel, not knitted)	+25%
Apparel, knitted	+14%

Footwear	+18.9%

Exports for the period January - November 2008 were 24.17% higher y-o-y.

¶7. (U) Indonesian imports fell 17.87% in November, to USD8.72 billion. Key import results (on m-o-m basis) included:

Iron and steel	-33.5%
Cereals	-66%
Electrical machinery	-18.6%
Organic chemicals	-35.2%
Mechanical appliances	-12.4%

The November trade balance improved to USD 890 million (up from a USD 200 million surplus recorded in October). BI has forecast that Indonesian export and import performance will continue to weaken in 2009, resulting in a projected current account deficit of about 0.11% of GDP.

¶8. (U) Export weakness extended broadly across most trading

partners, with non-oil and gas exports to Japan, Taiwan, ASEAN, and Europe declining by 18%, 23%, 9% and 7.6% m-o-m respectively. However, non-oil and gas exports to the U.S., China and Australia rose by 1.4%, 8.6% and 6% m-o-m respectively. Non-oil and gas imports from the U.S. declined by 24%.

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